Supreme Court, U.S.
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In the

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

No. 71-368

JACK E. GOLSEN and SYLVIA H. GOLSEN,
Petitioners,

VERSUS

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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September, 1971

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The petitioners pray that a writ of certriorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals, which appears at Appendix A, *infra*, pages i-ix, is reported by Commerce Clearing House in Vol. 71-2 *U. S. Tax Cases* ¶9497. The opinion of the United States Tax Court, printed in Appendix B, *infra*, pages xi-xxxv, is reported at 54 TC 742, and by Commerce Clearing House in *Tax Court Reports* as Dec. 30,049.

JURISDICTION

The Judgment of the Court of Appeals for the Tenth Circuit was entered June 18, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

Whether the prearranged borrowing of the cash values created by premiums paid or prepaid under policies of life insurance acquired prior to the effective date of 26 U.S.C. §264(a)(3) and having substantial economic significance apart from expected tax benefits, which premiums were larger than might have been necessary had the taxpayer selected an alternate form of life insurance, is "indebtedness" within the meaning of 26 U.S.C. §163(a).

STATUTES INVOLVED

Internal Revenue Code of 1954:

Sec. 163. INTEREST

(a) *General Rule.* There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

* * * * * * *

[26 U.S.C. §163(a)]

Sec. 264. CERTAIN AMOUNTS PAID IN CONNECTION WITH INSURANCE CONTRACTS.

(a) *General Rule.* No deduction shall be allowed for—

(1) * * *

(2) * * *

(3) Except as provided in subsection (c), any amount paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance, endowment, or annuity contract (other than a single premium contract or a contract treated as a single premium contract) pursuant to a plan of purchase which contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of such contract (either from the insurer or otherwise).

Paragraph (2) shall apply in respect of annuity contracts only as to contracts purchased after March 1, 1954. Paragraph (3) shall apply only in respect of contracts purchased after August 6, 1963.

* * * * * *

[26 U.S.C. §264(a)]

STATEMENT OF THE CASE

The petitioners, Jack E. Golsen and Sylvia H. Golsen, are husband and wife and reside in Oklahoma City, Oklahoma. Petitioners filed a joint Federal income tax return for the calendar year 1962 with the District Director of Internal Revenue at Oklahoma City, Oklahoma. Sylvia H. Golsen is a party to this suit only because of her filing a joint return with her husband, and the term "petitioner" is used below to refer to petitioner Jack E. Golsen.

The jurisdiction of the United States Tax Court, the court of first instance, was invoked as a result of the petitioners' filing, within the time permitted by 26 U.S.C. §6213, of a petition for the redetermination of their Federal income tax liability for 1962.

During 1962 and the latter part of 1961, petitioner served as president of several affiliated private corporations whose indebtedness to banks he had personally guaranteed in the aggregate amount of approximately $1,750,000 by January 1, 1962. In addition, he personally owed over $500,000 as a result of a purchase in 1961 of a 50 per cent stock interest in one of these corporations (App. B xii-xiii).

Petitioner, owning approximately $230,000 in insurance on his life and assets not readily convertible into cash in the event of his death, applied to Western Security Life Insurance Company on December 28, 1961, for $2,000,000 in insurance on his life. On January 31, 1962, that company issued petitioner 20 identical "Executive Special" policies on his life with a total face value of $1,000,000 payable to his wife in the event of petitioner's death (App. B xiii).

The "Executive Special" policies were whole life insurance policies requiring higher premiums, $68,180, during the first 20 years than the $18,180 annual premium required to maintain the policies from the 21st policy year until petitioner's death. These larger premiums gave to the policies additional "basic cash surrender values" and death benefits (App. B xiii-xiv).

Separate and apart from the basic cash surrender value of the policies created by petitioner's paying each premium when due, it was contemplated that petitioner would establish a "prepaid premium fund" by paying the following four annual premiums in advance, but discounted by the 3 per cent interest factor the insurance company undertook to pay on this fund (App. B xv). The amount of the prepaid premium fund entered into the computation of the "total guaranteed cash value" (App. B xviii), which

was therefore larger than the "basic cash surrender value" of the policies, and provided additional benefits in case of death (App. B xiii-xiv). The policies guaranteed petitioner the right to borrow the "total guaranteed cash value" at an annual rate of 4 per cent (App. B).[1]

Prior to acquiring these policies, petitioner was furnished a schedule showing that if he prepaid four premiums at the time of the first premium payment, and thereafter maintained four annual premiums in the "prepaid premium fund," he could each year after the first borrow the increase in the "total guaranteed cash value" of the policies in an amount sufficient to prepay the discounted value of the premium that would fall due four years later and pay approximately one-half of the interest currently falling due (App. A v; App. B xvi). Thus it was contemplated that all annual premiums after the first be financed by borrowing.

This table furnished petitioner showed that the aggregate "basic cash surrender value" increased from $50,000 in the first policy year to $1,579,280 in the 20th policy year,[2] while the "total guaranteed cash value," assuming the "prepaid premium fund" was kept in full force until the 17th policy year, increased from $311,033.90 to $1,579,280 over the same period.[3] Similarly, the gross benefit payable in the event of petitioner's death increased from its first year

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[1] The terms "basic cash surrender value" and "total guaranteed cash value" are not used in either opinion below, as neither opinion distinguished between the two.

[2] Appendix B xvii, Column (2), labeled "Guaranteed Cash Value."

[3] Appendix B xvii, Column (4), designated "Total Cash Value—Including Prepaid Premiums."

value of $1,369,083.90 to its 20th year value of $3,160,000,[4] while the net death benefit payable on petitioner's death, assuming maximum loans against the "total guaranteed cash value," increased from $1,058,000 in the first policy year to $1,580,720 in the 20th policy year.[5]

On January 31, 1962, petitioner issued a check to Western Security Life Insurance Company in the amount of $321,611.90, in payment of the first year's aggregate premium of $68,180, plus a prepayment of $253,431.90 to create the contemplated "prepaid premium fund." On that same date, petitioner borrowed against the policies the full $50,000 "basic cash surrender value" plus $261,033.90, which was the remainder of the "total guaranteed cash value" of the policies, or a total of $311,033.90, assigning the policies as security for these loans (App. B xix).

On that same date, Golsen paid the insurance company $12,441.40 by separate check, which consisted of $2,000 of interest on the borrowing of the $50,000 "basic cash surrender value" of the policies, and $10,441.40 in interest on the borrowing of the remainder of the "total guaranteed cash value" of the policies (App. B xix).

The Tax Court held that no part of the $12,441.40 interest paid by petitioner to the Western Security Life Insurance Company in 1962 was deductible "interest on indebtedness" within the meaning of 26 U.S.C. §1636, explaining its holding:

> Since the "executive special" plan contemplated systematic borrowing of each policy's entire cash value, the policies effectively had no cash value and accord-

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[4] Appendix B xviii, Column (5) plus Column (9).

[5] Appendix B xvii, Column (9).

> ingly were comparable to renewable term insurance policies. The so-called annual premium on the "executive special" policies was set at an artificially high level so as to create an abnormally high cash value in order to facilitate or make possible the purported lending transaction, and Golsen's annual out-of-pocket expense or net cash flow (i.e., the payments denominated as interest, reduced by the cash that was returned by the insurance company) is merely the amount that was actuarially required to pay for or support the insurance benefits available under the policies when stripped of their cash surrender values (App. B, xxv).

Citing its prior decision in *Goldman* v. *U. S.*, 403 F.2d 776 (1968), which held that borrowings against similar policies were not "indebtedness" under this Court's decision in *Knetsch* v. *U. S.*, 364 U.S. 361 (1960), the Court of Appeals for the Tenth Circuit affirmed the Tax Court, stating:

> We agree with the Tax Court that the loan and interest transactions involved with this insurance plan lacked economic substance. The loan and interest transactions have no purpose other than the conversion of payments for insurance coverage into interest payments for tax purposes (App. A vi).

REASONS FOR GRANTING THE WRIT

1. The decision of the Tenth Circuit in this case is in conflict with the decision of the Court of Appeals for the Fifth Circuit in *Campbell* v. *Cen-Tex, Inc.*, 377 F.2d 688 (1967). Presently pending on appeal before the Court of Appeals for the Sixth Circuit is the case of *Woodson-Tenent Laboratories, Inc.* v. *United States*, 71-1 *U. S. Tax Cases* ¶9216 (1970), which the District Court for the Western District of Tennessee held not to be distinguishable from

Cen-Tex, Inc., and if affirmed, will present a second conflict not capable of resolution without review by this Court.

In *Cen-Tex, Inc., supra,* the taxpayer corporation purchased before the effective date of 26 U.S.C. §264(a)(3) policies of life insurance on key employees and stockholders which policies had financing features, including prepayment of premiums, identical in substance to those of petitioner's "executive special" policies, for the purpose of funding its deferred compensation plans and stock redemption agreements. Noting that the aggregate net death benefit payable under these policies, assuming that maximum permissible loans against the "total guaranteed cash value" would first be deducted from the gross death benefits, increased from $700,000 to $1,131,000 during the first 20 policy years, the Fifth Circuit held that the loans of the "total guaranteed cash value" to the taxpayer constituted "indebtedness" for purposes of 26 U.S.C. §163, interest on which was deductible. In rejecting the respondent's contention that no "indebtedness" existed under this Court's decision in *Knetsch* v. *U. S.*, 364 U.S. 361 (1960), the Fifth Circuit stated:

> [T]here was a bona fide business purpose and an economic objective to be served by the insurance. The Knetsch situation of nothing to be realized but a tax reduction is not present. . . . These potential death benefits and cash surrender values cannot be brought within the Knetsch characterization of a "relative pittance." . . . The policies purchased provided for a beneficial interest. The transaction was not without economic value, economic significance, economic substance, or commercial substance. None of the Knetsch touchstones which can be applied to the transaction show it to be a sham. [Footnotes omitted] 377 F.2d 688, 692-693.

In two materially identical factual situations, the Courts of Appeals for the Fifth and Tenth Circuits applied the tests enunciated by this Court in *Knetsch* in conflicting fashions. The Fifth Circuit has interpreted *Knetsch* as allowing the deduction for "interest on indebtedness" if the entire transaction giving rise to the interest produces a substantial benefit to the taxpayer beyond and apart from a tax deduction.[6] The Tenth Circuit has interpreted *Knetsch* as denying an interest deduction if the loan fragment of the transaction, without regard to the underlying purpose of the entire transaction, does not appear to meet the criteria for "interest on indebtedness" as set forth in *Knetsch.*[7]

It may be argued that the application of the criteria of *Knetsch* to the integral transaction as the Fifth Circuit did in *Cen-Tex, Inc.* was implicitly rejected by this Court through its disapproval,[8] in *Knetsch, supra,* of the Fifth Circuit's holding in *United States* v. *Bond,* 258 F.2d 577 (1958). However, that disapproval was expressed in a footnote to this Court's statement: "There may well be single-premium annuity arrangements with non-tax substance which create an 'indebtedness' for purposes of . . . Sec. 163(a) of the 1954 Code. But this one is a sham."[9] The disapproval appears to be limited to the peculiar facts of the annuity transaction there involved. In its *Cen-Tex, Inc.* opinion, the Fifth Circuit noted this Court's rejection of

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[6] *Campbell* v. *Cen-Tex, Inc., supra.*

[7] *Goldman* v. *U. S.,* 403 F.2d 776 (1968), and the instant case.

[8] *Knetsch, supra,* at Footnote 4 of the Court's opinion; *U. S.* v. *Salley,* 290 F.2d 708 (5th Cir., 1961).

[9] 364 U.S. 361, 366.

its prior decision in *Bond*, and impliedly held that rejection did not add a qualification of the term "indebtedness" that was not stated in the body of this Court's *Knetsch* opinion.

The conflict with the holding of the Fifth Circuit in *Cen-Tex, Inc.* was clearly recognized by the Tenth Circuit, which stated:

> [T]o the small extent that *Goldman* [*supra*] and *Cen-Tex* are possibly distinguishable, the considerations go against the Golsens. . . . Assuming *arguendo* that this distinction would make a difference, Golsen's purpose of protecting his *family* from his *personal* indebtedness on business debts of corporations does not qualify as a business purpose in the same manner as Cen-Tex, Inc.'s purpose (App. A viii).

Petitioner submits that this injection of the distinctions between a "trade or business" and an "investment," necessary to the determination of the nature of a loss [*Whipple* v. *Commissioner*, 373 U.S. 193 (1963)], are without purpose in this case, for interest incurred in either pursuit is deductible[10] while payment of insurance premium by Cen-Tex, like premiums paid by petitioner for protection of his family, would not have been deductible.[11]

The conclusion of the Tenth Circuit that the net death benefits under petitioner's policies were separable from the borrowing of the "total guaranteed cash value" and were,

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[10] 26 U.S.C. §163(a). However, deduction of interest attributable to investment indebtedness is limited in taxable years beginning after 1971 by §221(a) of P.L. 91-172, appearing as 26 U.S.C. §163(d).

[11] 26 U.S.C. §264(a)(1), §262.

in fact, term insurance, was also raised and given summary treatment before the Fifth Circuit:

> Perhaps the Government has a broader definition of term insurance than is generally used. A term policy of life insurance is one which is issued for a limited and specified period with benefits payable only if death occurs within the period. Term policies do not, generally, have reserve values. 1 Richards on Insurance, Fifth Ed. 53, Sec. 14. The policies purchased by Cen-Tex were not policies of term insurance.[12]

The Fifth Circuit did not see necessary to add that the finding of fact in that case, like the finding of fact in this case,[13] that the payment of each year's premium increased the net death benefit payable, is in conflict with the conclusion that the net death benefits were comparable to term life insurance.

2. The question presented is of utmost importance in the administration of Federal tax laws. Although the exact number of pending cases to which both *Cen-Tex, supra,* and this case are directly in point is not known to petitioner, the following are pending in Court:

> *Woodson-Tenent Laboratories, Inc.* v. *U. S.*, 71-1 *U. S. Tax Cases* ¶9216 (W.D. Tenn. 1970), on appeal to the Sixth Circuit;
>
> *R. E. Lee and Jane S. Lee,* Tax Court Docket No. 5585-70;
>
> *M. S. Lee and Geraldine C. Lee,* Tax Court Docket No. 5586-70.

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[12] *Campbell* v. *Cen-Tex,* 377 F.2d 688, 693.

[13] Appendix B xiii-xiv; Appendix A iv.

Petitioner is unable to determine the number of cases involving these same questions presently pending before the administrative levels of the Treasury Department, or that have been decided at those levels.

If the prayed for writ is granted and the decision of the Court of Appeals is ultimately upheld, the deduction of interest for borrowings against the policies of even those taxpayers whose cases have been decided favorably to them will not be immune from attack. *Commissioner of Internal Revenue* v. *Sunnen*, 333 U.S. 591 (1948). These cases decided contrary to the Court of Appeals decision in this case, but not pending review, are:

Priester Machinery Company, Inc. v. *U. S.*, 296 F.Supp. 604 (W.D. Tenn. 1969);

Wanvig v. *U. S.*, 295 F.Supp. 882 (E.D. Wisc. 1969);

Blackmon v. *U. S.*, 68-2 *U. S. Tax Cases* ¶9655, (N.D. Tex. 1968).

The decisions in this case, *Cen-Tex, Inc., supra,* and *Woodson-Tenent Laboratores, Inc., supra,* are independent of 26 U.S.C. §264(a)(3), which might limit the deductibility of interest in these cases had the policies been purchased after August 6, 1963. Each of these cases seeks to interpret the term "indebtedness," which is the underlying essential of the interest deduction, with broad implications with regard to all borrowings against life insurance.

Insofar as the decision of the Tenth Circuit in this case is based on the finding that premiums currently paid by petitioner were "unusually high," thus making possible the loan transactions against the "basic cash value" of the poli-

cies, this Court's decision not to grant the prayed for writ would cast doubt on the validity of all borrowings within the Tenth Circuit's jurisdiction against the value of limited payment life insurance policies, under which the term of 20 years for payment of all premiums due during the life of the policy is quite common.

CONCLUSIONS

The decision of the Tenth Circuit in this case, its conflict with the decision of the Fifth Circuit, and the pending further conflict of one of these decisions with that of the Sixth Circuit present an uncertain framework for the planning by taxpayers of one of the most common of their affairs, the arrangement of life insurance. Furthermore, dealing as these decisions do with the broad meaning of the term "interest," independent of its use in the narrow confines of 26 U.S.C. §264, this uncertainty extends far beyond the factual boundaries of the instant case. Accordingly, this petition for writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

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UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

MAY TERM, 1971

JACK E. GOLSEN and SYLVIA H. GOLSEN, Appellants,	)	
v.	)	No. 310-70
COMMISSIONER OF INTERNAL REVENUE, Appellee.	)	

ON APPEAL FROM THE DECISION OF THE
UNITED STATES TAX COURT
(Docket No. 5863-65)

Julian P. Kornfeld of Andrews, Mosburg, Davis, Elam, Legg & Kornfeld for Appellants

Johnnie M. Walters, Assistant Attorney General (Joseph M. Howard, Bennet N. Hollander and William S. Estabrook, Attorneys, Tax Division, Department of Justice, on the brief) for Appellee.

Before LEWIS, Chief Judge, and McWILLIAMS and DOYLE, Circuit Judges.

DOYLE, Circuit Judge.

[APPENDIX]

This is an action in which the plaintiffs-appellants sought an income tax refund in the amount of $2,918.15 growing out of an assessed deficiency for the taxable year 1962. The item in dispute is tax assessed on what purports to be an interest payment to Western Security Life Insurance Company. The taxpayers deducted this interest in the amount of $12,441.40. The Commissioner disallowed the interest deduction whereupon this action was commenced. The Tax Court upheld the Commissioner, thus determining that the interest deduction was not proper under 26 U.S.C. § 163(a).[1]

The case before us revolves around the issuance on January 31, 1962, by Western Security Life Insurance Company to the Golsens life insurance in the face amount of $1,000,000 consisting of twenty "executive special" policies, each having a face amount of $50,000 and an effective date of December 28, 1961. They named Jack E. Golsen as insured, and Mrs. Golsen as beneficiary; their three children are contingent beneficiaries. The "executive special" policies appeared on their faces to be whole life policies, providing for aggregate premiums of $68,180 a year for the first twenty years and $18,180 a year thereafter.

The "executive special" policies implemented an insurance program embodying the following principal elements:

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[1] The essence of the decision of the Tax Court was, first, that the complex of loans from Western to the insured in connection with the insurance policies issued on his life were sham and as such were designed first to pay for bare insurance coverage and, secondly, to give to the appellants an interest deduction which would serve to pay for this coverage. The court found that the loans were not binding obligations; that they were subject to cancellation which merely required offsetting debits and credits on Western's books. The Tax Court determined that it was bound to follow this court's decision in Goldman v. United States, 403 F.2d 776 (10th Cir. 1968), and that *Goldman* was exactly in point.

1. The insured first "borrowed" from Western the entire amount of the first year cash value, which he used simultaneously to pay the greater part of the first year's premium.

2. He, at the same time, "borrowed" a much larger sum from Western. With most of the proceeds of the "loan" he simultaneously established a so-called "prepaid premium fund" in the amount of the present value of the aggregate annual premiums for the following four years, discounted at an annual rate of three percent. Western undertook to pay interest on the "prepaid premium fund" at the rate of three percent a year, and that fund, when supplemented by the interest increments paid by Western, were sufficient at each of the next four anniversary dates of policies to pay the annual aggregate premium of $68,180.

3. At the beginning of the first year, the insured simultaneously paid in advance that year's four percent "interest" on the sums he had "borrowed."

4. As the "prepaid premium fund" was reduced each year thereafter by the purported payment of premiums therefrom for such year, the insured was in turn to "replenish" the fund by a "prepayment" in respect of the premiums to become due four years thereafter. The amount thus added to the fund each year was $60,577.90, which, at three percent compound interest, was expected to increase to $68,180 four years thereafter and accordingly be sufficient to pay the premiums falling due at that time.

5. Each year after the issuance of the policies, the insured would "borrow" the full amount of the increase in the loan value of the policies for that year, and he would simultaneously use part of the proceeds of such "loan" to pay the full amount of $60,577.90 to be added to the "prepaid premium fund" and would use the balance to pay part of the annual "interest" charges on his growing indebtedness to Western.

6. After the first year, no part of the insured's out-of-pocket costs would be allocable to premiums, and, as a consequence of treating the "interest" as deductible, the insured's actual cost of the insurance purchased by him would either be comparatively nominal or result in a net profit to him. The insured was never to be personally liable on any of his "loans," and the policies would never in *fact* have *any* cash surrender value as a result of the "loans."

The table which is set forth below shows the approximate figures as to some of the more important elements of Golsens' life insurance program.[2]

As each year's $68,180.00 premium is paid out of the prepaid premium fund, the cash (or loan) value of the policy increases and the value of the death benefit increases. In fact, examination of column (1) indicates that the cash value increases by an increasing amount which after the third policy year exceeds the amount of the $68,180.00 annual premium. Whether these substantial

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2.

(1) Increase in Cash Value from Preceding Year*	(2) "Borrowing" Used to Pay Discounted Premium	(3) Remaining Cash Value Available for Pmt of Interest	(4) "Interest" Payments	(5) Out-of-Pocket Expenses
50,000.00	50,000.00	-0-	12,441.40	23,019.40
66,940.00	60,577.90	6,362.10	15,119.00	8,756.90
68,500.00	60,577.90	7,922.10	17,859.00	9,936.90
70,060.00	60,577.90	9,922.10	20,661.40	11,179.30
71,630.00	60,577.90	11,052.10	23,526.60	12,474.50
73,220.00	60,577.90	12,642.10	26,455.40	13,813.30
74,790.00	60,577.90	14,212.10	29,447.00	15,234.90
76,360.00	60,577.90	15,782.10	32,501.40	16,719.30
77,920.00	60,577.90	17,342.10	35,618.20	18,276.10
79,460.00	60,577.90	18,882.10	38,796.60	19,914.50
80,980.00	60,577.90	20,402.10	42,035.80	21,633.70
82,470.00	60,577.90	21,892.10	45,334.60	23,442.50
83,920.00	60,577.90	23,342.10	48,691.40	25,349.30
85,340.00	60,577.90	24,762.10	52,105.00	27,342.90
86,680.00	60,577.90	26,102.10	55,572.20	29,470.10
87,980.00	60,577.90	27,402.10	59,091.40	31,689.30
89,180.00	62,351.50	26,788.50	60,162.90	33,374.40
90,300.00	64,266.40	26,033.60	61,204.20	35,170.60
91,330.00	67,196.00	24,134.00	62,209.60	38,075.60
92,220.00	68,180.00	24,040.00	63,171.20	39,131.20

*These amounts, which are added to the total cash value balance each year, are available for borrowing each year by the insured.

amounts of cash value increases are due to an amount of "implicit interest" paid to the policyholder on the cash value on deposit with the insurance company was not determined by the Tax Court. The Tax Court did determine that "[t]he so-called annual premium on the 'executive special' policies was set at an artificially high level so as to create an abnormally high cash value in order to facilitate or make possible the purported lending transaction . . ." Golsen v. Comm'r, 54 T.C. No. 70, at 17 (filed April 9, 1970). In any event, Golsen did not declare as income or pay taxes on any portion of the increase in cash value over and above the amount of his premium payments, nor did he declare as income or pay taxes on any of the 3 percent annual interest which the insurance company paid on the "prepaid premium fund." Yet, he was able to "borrow" each year against the full amount of both funds and, of course, he deducted the amount of interest which he paid on these "loans."

Golsen's annual loans (in the amounts of the cash value increases shown in column (1) above) were just sufficient to replenish the "prepaid premium fund *and* to pay approximately half of the "interest" charges on his "loans." (Column 3.) Thus, his out-of-pocket expenses were also approximately one-half of his so-called "interest" charges, and the tax savings realized by deducting the "interest" charges against his other income were (assuming a 52 percent tax bracket) just enough to generally offset the amount of his out-of-pocket expenses. It is also no coincidence that Golsen's annual out-of-pocket expense or net cash flow was found by the Tax Court to be "merely the amount that was actuarially required to pay for or support the insurance benefits available under the policies when stripped of their cash surrender values." *Id.* at 18. It was upon this basis that the Tax Court found that in reality "[s]uch 'interest' payments in fact represent the cost to the insured of the insurance benefits provided by the 'executive special' policies under the prearranged plan and do not

represent payment for the use of borrowed funds."[3] Thus, the Tax Court found that the superstructure of "loans" and "interest payments" surrounding the basic insurance transaction was sham and lacked economic substance, and that therefore the "interest payments" did not qualify as deductions pursuant to 26 U.S.C. § 163(a), as payment for the use of borrowed funds.

We agree with the Tax Court that the loan and interest transactions involved with this insurance plan lacked economic substance. The loan and interest transactions have no purpose other than the conversion of payments for insurance coverage into interest payments for tax purposes. As stated by the Tax Court,

> Golsen's "loans" were secured solely by the policies themselves and the so-called premium prepayment fund, without any personal liability on his part; the "loans" could be cancelled at any time without any cash payment, merely by appropriate offsetting book entries, and the full amount of the so-called premium prepayment fund was in fact thus "charged off" on Western's books on January 26, 1967, accompanied by a corresponding entry reducing Golsen's "indebtedness" by the amount allocable to such "fund."

In denying the Golsens claim for refund, the Tax Court held that it was bound by the decision of this Court in

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[3] Golsen v. Comm'r, 54 T.C. No. 70. The court based this conclusion upon the testimony of an actuary who established to the court's satisfaction

> that the receipt and prepayment agreement and the loan agreement and assignment of policy has no essential relationship whatever to the insurance benefits provided under the insurance contracts, that when, in accordance with the prearranged plan, the policy was stripped of its artificially high cash surrender values, such policy was merely the equivalent of renewable term insurance, and that actuarially the net cash which the insured in fact paid to the insurance company, however described, merely represented the true cost of the insurance purchased.

Id., at 22.

Goldman v. United States, 403 F.2d 776 (10th Cir. 1968), because the appeal from the Tax Court's decision could only be brought in this Court.

In *Goldman* we considered an insurance-loan program which was written by the same company, Western Security[,] and which had attributes similar to those present in the instant case. Involved were interest payments to Western Security which, as here, exceeded the rate paid by the insurance company on the surrender value. It was the interest transaction which was the predominant aspect and which led this Court to conclude: (403 F.2d at 778)

> The policy itself clearly reflects that the interest on the loans was 4% and the annual yield or increase in policy value was at the rate of 3%. The annual loss of 1%, when the record reveals the taxpayer was not pressed for cash, indicates a lack of economic substance in these transactions.

The Court in *Goldman* was guided by the decision of the Supreme Court in Knetsch v. United States, 81 S.Ct. 132 (1960), in which the insurance program was devoid of substance. There it was said:

> * * * For it is patent that there was nothing of substance to be realized by Knetsch from this transaction beyond a tax deduction. What he was ostensibly "lent" back was in reality only the rebate of a substantial part of the so-called "interest" payments. The $91,570 difference retained by the company was its fee for providing the facade of "loans" whereby the petitioners sought to reduce their 1953 and 1954 taxes in the total sum of $233,297.68. There may well be single premium annuity arrangements with nontax substance which create an "indebtedness" for the purposes of § 23(b) of the 1939 Code and § 163(a) of the 1954 Code. But this one is a sham.

The Tax Court rejected Cen-Tex v. Campbell, 377 F.2d 688 (5th Cir. 1967), which it also deemed to be directly in point, "[d]espite some rather feeble attempts on the part of each side herein to distinguish the case adverse to it * * *." We agree that we are bound by our *Goldman* decision in this case; to the small extent that *Goldman* and *Cen-Tex* are possibly distinguishable, the considerations go against the Golsens.

Appellants contend that *Goldman* and *Cen-Tex* are distinguishable inasmuch as in *Goldman* no business purpose was found, while in *Cen-Tex* the Fifth Circuit found that Cen-Tex, Inc., the corporation[,] had procured the insurance policies to "assist in meeting the obligations of Cen-Tex under its deferred compensation plan and its obligations under the stock option and redemption agreement as well as for the general objective of having insurance upon its key employees and stockholders. * * * Assuming *arguendo* that this distinction would make a difference, Golsen's purpose of protecting his *family* from his *personal* indebtedness on business debts of corporations does not qualify as a business purpose in the same manner as Cen-Tex, Inc.'s purpose. *See also* Priester Machinery Co. v. United States, 296 F. Supp. 604 (W.D. Tenn. 1969) (wherein the business purpose was to cushion the corporation in the event of its president's death and to facilitate the making of business loans).

Appellants also contend that *Cen-Tex* is distinguishable from *Goldman* in that *Cen-Tex* found economic substance in the *insurance* transaction because the net death benefits under the policy were substantial and increased from year to year. Appellant argues that after subtracting all loans against the policies, the net death benefits were substantial in amount under the policies in both *Cen-Tex* and this case, while in *Goldman* they were not. An examination of the district court opinion in *Goldman*, however, (Goldman v. United States, 273 F. Supp. 137 (W.D. Okla.

1967)) does not bear this out. Regardless, however, of whether the insurance coverage as such may have had some value, we are of the opinion that the superimposed loan transactions had no economic substance, and hence the interest deduction must fail.[4]

One final argument advanced by appellant is that the loan transaction itself (or a part thereof) took advantage of a "loophole" in the tax law which was clearly recognized by the Internal Revenue Service, and which was not "plugged" until 1965. The 3 percent discount element of the prepaid premium deposit fund was until late in 1965 considered as nontaxable,[5] and there should not therefore be any reason to believe that the full 4 percent interest paid on money "borrowed" against that fund should not be dedeductible. However, this was all true in *Goldman* in which no economic substance was found; we are not disposed to overrule that decision.

It is true that when Congress "plugged" the "loophole" involved here, it assumed that the law allowed such deductions. The Revenue Act of 1964 amended § 264 of the Internal Revenue Code of 1954 to read in part as follows:

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[4] *See* Ballagh v. United States, 331 F.2d 874 (Ct. Cl. 1964), *cert. denied*, 379 U.S. 887 (1964), wherein the court stated, at 878:

> [P]laintiff is wide of the mark in supposing that his primary purpose of providing retirement income can make valid what would otherwise be a sham. For the transaction which we find to be a sham is not the initial insurance contract but the prepayment of all of the premiums and the loan agreement. We do not question that plaintiff's purpose in buying the policy was a legitimate one. However, the subsequent prepayment of all premiums by borrowing from the insurance company itself was not necessary in so providing retirement income, and we find that such loan transaction did "not appreciably affect his beneficial interest except to reduce his tax."

See also Minchin v. Commissioner, 335 P.2d 30, 32 (2d Cir. 1964).

[5] I.T. 3513, 1941-2 CB 75; Rev. Rul. 65-24, 1965-1 CB 31. The Internal Revenue Service reversed their position in Rev. Rul. 65-199, 1965-2 CB 20.

[APPENDIX]

(a) *General Rule.* No deduction shall be allowed for—

* * * * * * *

(2) Except as provided in subsection (c), any amount paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance . . . contract . . . pursuant to a plan of purchase which contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of such contract (either from the insurer or otherwise).

. . . Paragraph (3) shall apply only in respect to contracts purchased after August 6, 1963.

The House Ways and Means Committee Report interpreted then existing law as follows:

. . . [U]nder present law, no interest deductions are denied where the taxpayer purchases an insurance contract with the intention of borrowing the maximum amount on the contract each year, unless the contract falls in one of the categories described above.[6]

However, we are not bound by Congress' interpretation of prior existing law.

The fact, however, that Congress considered it expedient to remedy an avoidance device which had at least some court recognition does not bind us in dealing with a specific fact situation.

The judgment of the Tax Court is affirmed.

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[6] H. Rept. No. 749, 88th Cong., 1st Sess. 1964-1 CB (Part 2) 185. *See also* Report of the Senate Finance Committee, Report No. 830, 88th Cong., 2d Sess. 1964-1 CB (Part 2) 581.

APPENDIX B

54 T. C. No. 70

UNITED STATES TAX COURT

JACK E. GOLSEN and SYLVIA H. GOLSEN, Petitioners *v.* COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 5863-65. Filed April 9, 1970.

T purchased 20 "executive special" life insurance policies that were specially designed, calling for abnormally high premiums and providing for correspondingly high loan and cash surrender values. As part of a pre-arranged plan T not only "paid" the first year's premiums but also made "payments" into a "pre-paid premium fund" in respect of the premiums to become due in the next four years, and he simultaneously "borrowed" back not only the full amount of the "pre-paid premium fund" but also the full loan value of the policies created by the first year's premium. His "interest" obligations in respect of such "loans" were at the annual rate of four percent, whereas the company's "interest" obligation to him on the "prepaid premium fund" was at the rate of three percent. The plan contemplated the "borrowing" annually of the full amount of the annual increase in the cash surrender value of the policies, which was greater than the amount to be paid annually into the "prepaid premium fund" to maintain it for a four year period. The net result of the transaction was that, apart from a portion of the cash actually paid by T as the first year's premium, no part of his out-of-pocket costs over the life of the policies would be treated as premium but would all be reflected "interest" paid by him. *Held*, T's out-of-pocket costs were in substance the true cost of the insurance purchased by him and he did not in fact pay any "interest" on borrowed funds. T is not entitled to any deduction

for "interest" paid. Section 163, I.R.C. 1954. The result follows *Goldman* v. *United States*, 403 F. 2d 776 (C.A. 10), rather than the contrary holding in *Cen-Tex* v. *Campbell*, 377 F. 2d 688 (C.A. 5). The present case is within the Tenth Circuit and is therefore governed by *Goldman*. To the extent that *Arthur L. Lawrence*, 27 T.C. 713, is inconsistent herewith it is overruled.

Julian P. Kornfeld and *Robert B. Milsten*, for the petitioners.

Harold Friedman, for the respondent.

The Commissioner determined a deficiency of $2,918.15 in petitioners' income tax for 1962. The only issue is whether a $12,441.40 payment made by petitioner Jack E. Golsen to the Western Security Life Insurance Company is deductible as an interest payment pursuant to section 163, I.R.C. 1954.

FINDINGS OF FACT

The parties have stipulated certain facts, which, together with the attached exhibits, are incorporated herein by this reference.

Petitioners, Jack E. and Sylvia H. Golsen, are husband and wife. They filed a joint Federal income tax return for the calendar year 1962 with the district director of internal revenue, Oklahoma City, Oklahoma, and resided in Oklahoma City at the time the petition was filed in this case.

During the latter part of 1961 and during 1962, Jack E. Golsen ("Golsen") served as president of Hart Industrial Supply Company and several affiliated corporations. The corporations were privately owned and did business in Texas and Oklahoma. By the end of 1961 the corporations had incurred indebtednes to banks in the aggregate amount of about $1.75 million, and Golsen had personally guaranteed all of it. Golsen was also personally indebted to a bank in the amount of $15,000. Moreover, during 1961 he had

purchased 50 percent of the stock of the L & S Bearing Company for approximately $625,000.

In December of 1961, Golsen carried about $230,000 in life insurance protection. In addition, several of the corporations whose loans he had guaranteed had taken out insurance on his life. However, in view of the size of his potential liabilities and his relatively illiquid financial position in late 1961, Golsen thought that he ought to purchase additional life insurance to protect his family in the event of his unexpected death.

On or about December 28, 1961, an application was made to Western Security Life Insurance Company of Oklahoma City (hereinafter sometimes referred to as "Western" or the "insurance company") for insurance on Golsen's life. The application requested insurance in the total amount of $2,000,000 to be embodied in 40 "executive special" policies of $50,000 each, with Mrs. Golsen as the beneficiary and the couple's three children as contingent beneficiaries. No cash was submitted with the application.

Subsequently, on or before January 31, 1962, Western issued to Golsen such life insurance in the amount of $1,000,000 embodied in 20 "executive special" policies, each with a face amount of $50,000 and an effective date of December 28, 1961.[1] On the date of issue Golsen was 33 years old and had a life expectancy of 35.15 years.

The "executive special" policies appeared on their face to be whole life policies, providing for aggregate premiums of $68,180 a year for the first 20 years and $18,180 (reflecting a reduction of $50,000) a year thereafter. The premiums during the first 20 years were substantially higher than

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[1] At about the same time some of the corporations in which Golsen had an interest purchased similar policies on his life in the aggregate amount of $1,000,000. Since the application referred to above sought insurance in the total amount of $2,000,000, the policies purchased by the corporations may have related in some manner to that application. However, such policies are not involved in this case.

were actuarially required, and consequently the aggregate amount payable on death ("death benefits") as well as the cash surrender and loan values increased substantially during each of the first 20 years. The following table shows by policy year, the total death benefits, cash or loan values, and the net death benefits remaining if loans in the maximum permissible amounts were made against the policies:

Policy Year	Total Death Benefit	Cash or Loan* Value	Net Death Benefit
1	$1,108,000	$ 50,000	$1,058,000
2	1,216,000	116,940	1,099,060
3	1,324,000	185,440	1,138,560
4	1,432,000	255,500	1,176,500
5	1,540,000	327,130	1,212,870
6	1,648,000	400,350	1,247,650
7	1,756,000	475,140	1,280,860
8	1,864,000	551,500	1,312,500
9	1,972,000	629,420	1,342,580
10	2,080,000	708,880	1,371,120
11	2,188,000	789,860	1,398,140
12	2,296,000	872,330	1,423,670
13	2,404,000	956,250	1,447,750
14	2,512,000	1,041,590	1,470,410
15	2,620,000	1,128,270	1,491,730
16	2,728,000	1,216,250	1,511,750
17	2,836,000	1,305,430	1,530,570
18	2,944,000	1,395,730	1,548,270
19	3,052,000	1,487,060	1,564,940
20	3,160,000	1,579,280	1,580,720
22	3,160,000	1,664,100	1,495,900
27	3,160,000	1,876,110	1,283,890
32	3,160,000	2,082,770	1,077,230

*Loan value is available at any time during the policy year stated if premium is paid to end of such year.

Interest on policy loans was payable at the rate of four percent a year.

The "executive special" policies implemented an insurance program embodying the following principal elements: First, the insured would "borrow"[2] from Western the entire amount of the first year loan value, which he would use simultaneously to pay the greater part of the first year's premium. Second, he would at the same time "borrow" a much larger sum from Western, and with most of the proceeds of the "loan" he would simultaneously establish a so-called "prepaid premium fund" in the amount of the present value of the aggregate annual premiums for the following four years, discounted at an annual rate of three percent. Western would undertake to pay interest on the "prepaid premium fund" at the rate of three percent a year, and that fund, when supplemented by the interest increments paid by Western, would be sufficient at each of the next four anniversary dates of the policies to pay the annual aggregate premium of $68,180. Third, at the beginning of the first year, the insured would simultaneously pay in advance that year's four percent "interest" on the sums he "borrowed." Fourth, as the "prepaid premium fund" was reduced each year thereafter by the purported payment of premiums therefrom for such year, the insured would in turn "replenish" the fund by a "prepayment" in respect of the premiums to become due four years thereafter. The amount thus to be added to the fund each year was $60,577.90, which, at three percent compound interest was expected to increase to $68,180 four years thereafter and accordingly be sufficient to pay the premiums falling due at that time. Fifth, each year after the issuance of the

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[2] In order to avoid any characterization as to the genuineness of such borrowing, the parties have used the term "allegedly borrowed" in their stipulation of facts. A similar procedure is adopted in these findings; the word "borrow" and like terms are enclosed in quotation marks simply to describe the events which occurred without drawing any conclusion at this point as to the existence of any bona fide debt, etc.

policies, the insured would "borrow" the full amount of the increase in the loan value of the policies for that year, which would be greater than the $60,577.90 added to the "prepaid premium fund" (see column 3 of table, p. xiv, *supra*), and he would simultaneously use part of the proceeds of such "loan" to pay the full amount of $60,577.90 to be added to the "prepaid premium fund" and would use the balance to pay part of the annual "interest" charges on his growing indebtedness to Western. Sixth, thus, after the first year, no part of the insured's out-of-pocket costs would be allocable to premiums, and, as a consequence of treating the "interest" as deductible, the insured's actual cost of the insurance purchased by him would either be comparatively nominal or result in a net profit to him. The insured would never be personally liable on any of his "loans," the policies would never in fact have any cash surrender value as a result of the "loans," and the death benefits would be those shown in the last column of the table at p. xiv, *supra*.

Prior to acquisition of the policies Golsen was furnished with a schedule (based upon assumed insurance in the amount of $100,000) outlining the mechanics of the "executive special" plan. The schedule showed that under the plan there would be no net cash premium outlay after the first year and that if the "interest" payments were treated deductible for income tax purposes, the actual net cost of the insurance over the first 20 years to the taxpayer at an assumed tax bracket would be a comparatively nominal amount, and in some years there might even be a net profit. That schedule (when multiplied by 10 so as to conform to the $1,000,000 insurance involved herein) in general reflects the plan which Golsen and Western ultimately adopted. It is set forth below:

JACK GOLSEM

(a) (Annual Premium - $6,818.00
(Discounted Premium - $6,057.79

Age 33

Base - $100,000.00

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Year	Guaranteed Cash Value	Prepaid Premium Fund	Total Cash Value-Incl. Prepaid Prem.	Amount of Loan	Interest at 4%	Net Cash Premium Outlay	Total Net Outlay With 52% Tax Cr.	Net Insurance Estate After Ded. Loan	Annual Increase In Cash Value	Net Cost Or Profit After Deletg. Excess Cash
1	$ 5,000.00	$26,103.39	$31,103.39	$ 31,103.39	$ 1,244.14	$1,057.80	$ 1,654.99	$105,800.00	$ -0-	$ -0-
2	11,694.00	26,103.39	37,797.39	37,797.39	1,511.90	-0-	725.71	109,906.00	636.21	(89.50)
3	18,544.00	26,103.39	44,647.39	44,647.39	1,785.90	-0-	857.23	113,856.00	792.21	(65.02)
4	25,550.00	26,103.39	51,653.39	51,653.39	2,066.14	-0-	991.75	117,650.00	948.21	(43.54)
5	32,713.00	26,103.39	58,816.39	58,816.39	2,352.66	-0-	1,129.28	121,287.00	1,105.21	(24.07)
6	40,035.00	26,103.39	66,138.39	66,138.39	2,645.54	-0-	1,269.86	124,765.00	1,264.21	(5.65)
7	47,514.00	26,103.39	73,617.39	73,617.39	2,944.70	-0-	1,413.46	128,086.00	1,421.21	7.75
8	55,150.00	26,103.39	81,253.39	81,253.39	3,250.14	-0-	1,560.07	131,250.00	1,578.21	18.14
9	62,942.00	26,103.39	89,045.39	89,045.39	3,561.82	-0-	1,709.67	134,258.00	1,734.21	24.54
10	70,888.00	26,103.39	96,991.39	96,991.39	3,879.66	-0-	1,862.24	137,112.00	1,888.21	25.97
11	78,986.00	26,103.39	105,089.39	105,089.39	4,203.58	-0-	2,017.72	139,814.00	2,040.21	22.49
12	87,233.00	26,103.39	113,336.39	113,336.39	4,533.46	-0-	2,176.06	142,367.00	2,189.21	13.15
13	95,625.00	26,103.39	121,728.39	121,728.39	4,869.14	-0-	2,337.19	144,775.00	2,334.21	(2.98)
14	104,159.00	26,103.39	130,262.39	130,262.39	5,210.50	-0-	2,501.04	147,041.00	2,476.21	(24.83)
15	112,827.00	26,103.39	138,930.39	138,930.39	5,557.22	-0-	2,667.47	149,173.00	2,610.21	(57.26)
16	121,625.00	26,103.39	147,728.39	147,728.39	5,909.14	-0-	2,836.39	151,175.00	2,740.21	(96.18)
17	130,543.00	19,864.24	150,407.24	150,407.24	6,016.29	-0-	2,887.82	153,057.00	2,678.85	(208.97)
18	139,573.00	13,437.60	153,010.60	153,010.60	6,120.42	-0-	2,937.80	154,827.00	2,503.36	(334.44)
19	148,706.00	6,818.00	155,524.00	155,524.00	6,220.96	-0-	2,986.06	156,494.00	2,513.40	(472.66)
20	157,928.00	-0-	157,928.00	157,928.00	6,317.12	-0-	3,032.22	158,072.00	2,404.00	(628.22)
					$80,200.43	$1,057.80	$39,554.03		$35,957.76	($1,541.28)

In terms of the particular data appearing thereon the schedule was based upon a plan purporting to provide for a whole life policy with the following features:

(1) increasing death benefits for the first 20 years (column (9));

(2) an increasing "guaranteed cash value" which would be available for "borrowing" or cash surrender by the insured (column (2));

(3) establishment in the first policy year of a "prepaid premium fund" (column (3));

(4) maintenance thereafter of a level "prepaid premium fund" by annual prepayment of a premium four years in advance (column (3));

(5) availability of the prepaid premium fund, as a supplement to the "guaranteed cash value" of the policy, for additional "borrowing" by the insured (column (4));

(6) annual "borrowing" by the insured of amounts sufficient to exhaust the total amount available for loans (the sum of the prepaid premium fund and the guaranteed cash value) (columns (4) and (5));

(7) allocation of a portion of each annual "loan" to the insured's annual premium prepayment and use of the remainder of such "loan" to offset in part his annual "interest" payments on his outstanding "loan" (columns (5) and (10) and figure (a));

(8) annual payments by the insured which, after the first year, were to be designated exclusively as "interest" payments on the then outstanding "loan" (columns (6) and (7)); and

(9) deductibility of the insured's annual payments as interest payments for Federal income tax purposes (column (8)).[3]

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[3] The "52% Tax Cr." in the schedule apparently contemplated the purchase of insurance on Golsen's life by a corporation with income taxable at a 52 percent rate.

As previously stated, Western issued 20 "executive special" policies, or contracts of insurance, to Golsen in the aggregate face amount of $1,000,000. Pursuant to the "executive special" plan, the following occurred on or about January 31, 1962, i.e., on the first date on which any payments were made in respect of the policies:

(1) Golsen issued a check in the amount of $321,611.90 to Western purportedly in payment of the first year's premium of $68,180 for the policies, plus a "prepayment" of $253,431.90 to create the "prepaid premium fund" which, when supplemented by the three percent interest accumulating thereon, would be sufficient to pay the next four annual premiums on the policies.

(2) Golsen "borrowed" from Western the full cash value of each policy, or a total of $50,000.

(3) Golsen also "borrowed" an additional $261,033.90 from Western making a total of $311,033.90 "borrowed" from Western.[4] "Interest" was payable on this entire "indebtedness" at the rate of four percent a year.

(4) In accordance with (2) and (3), Western issued a check to Golsen in the amount of $311,033.90.

(5) Golsen "paid" Western $12,441.40 by check, purportedly as four percent "interest" on the aggregate of $311,033.90 "borrowed" from Western.

(6) The foregoing $12,441.40 check cleared the bank on February 2, 1962.

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[4] One year's interest at three percent on the $253,431.90 "prepayment" is $7,602.96, and such "prepayment" plus such interest are substantially equal (within a difference of less than one dollar) to the $261,033.90 "borrowed" by Golsen. Since Golsen's obligation in respect of his "loan" from Western was to pay annual "interest" in advance at four percent, and since Western's obligation in respect of interest on the "prepaid" premiums was only three percent, its "loan" of the entire $253,431.90 "prepayment" plus one year's advance interest thereon to Golsen was entirely riskless from its point of view. Golsen, in substance, merely "borrowed" back simultaneously the entire "prepayment" plus one year's interest.

On the date Golsen's $321,611.90 check was written, there were not sufficient funds in petitioners' bank account to cover the check; payment thereof was dependent on the deposit of Western's $311,033.90 check.

Golsen's actual out-of-pocket expense in regard to this transaction was $10,578 of amounts designated as "premiums" or "advance premiums" plus the $12,441.40 "interest" which is here in issue.

Attached to each contract were two form documents entitled "Receipt and Prepayment of Premiums Agreement" ("Prepayment Agreement") and "Loan Agreement and Assignment of Policy" ("Loan Agreement"). The Prepayment Agreement form was executed by the President and Secretary of Western and provided in part as follows:

> Western Security Life Insurance Company acknowledges the receipt of $12,671.59 as prepayment of premiums under this policy.
>
> It is hereby agreed that in the event of the death of the Insured or application for any of the non-forfeiture benefits of said policy, all premiums paid beyond the current policy year will be commuted at 3% per annum compound interest. Such commuted amount will be paid as a part of the proceeds of the policy in the event of death or in the event of the application for non-forfeiture benefits will be returned to the owner of the policy.
>
> For the purpose of making loans on the policy, it is understood and agreed that the Company will include the present value of the prepaid premiums as a part of the loan, cash surrender, and reserve value of this policy.
>
> Any indebtedness applicable to this Agreement will be deducted in any settlement due the benficiary or the owner of this policy.

The Loan Agreement form had been executed by Golsen on December 28, 1961, and provided in part as follows:

LOAN AGREEMENT AND ASSIGNMENT OF POLICY

Pursuant to the provisions of Policy Number * * * issued by WESTERN SECURITY LIFE INSURANCE COMPANY of Oklahoma City, Oklahoma, on the life of Jack E. Golsen (The Insured), in consideration of a loan of Three Hundred Eleven Thousand Thirty Three and 90/100 Dollars ($311,033.90) by said Company, the receipt of which is hereby acknowledged, the undersigned hereby pledges, assigns, and transfers to said Company, its successors and assigns, said Policy and all rights and benefits thereunder, to secure the payment of said loan and the interest thereon and any other indebtedness to the Company on said Policy.

AUTOMATIC PREMIUM LOAN FOR PREPAYMENT OF PREMIUMS: The insured requests the Company, on each anniversary of the above numbered policy, to advance so much of the net cash value as is available at that time towards the prepayment of the next unpaid annual premium and agrees that any sum so advanced towards prepayment of said premium shall be an additional loan on said policy; provided, however that any sum advanced toward the prepayment of any premium or premiums due one or more years from such anniversary shall be maintained by the Company as deposit for the payment of such premiums when due and the said deposit, or balance thereof, will be credited with interest on each subsequent anniversary at the rate of three percent (3%) per annum, compounded annually.

It Is Hereby Agreed by the Undersigned:

First—That interest shall be paid to said Company in advance at the beginning of each policy year, at the

rate of 4% per annum on the amount of said loan, and that said interest, if not paid when due, shall be added to the principal and bear interest at the same rate and under the same conditions.

The $311,033.90 "loan" referred to in the foregoing agreement was composed of $50,000, the full first year loan value of the policies, plus $261,033.90 purportedly borrowed by Golsen from Western, as previously described.

On each subsequent year thereafter until the time of the trial herein, Golsen purported to borrow the entire amount of the annual increase in the cash value of the insurance policies as soon as it became available for borrowing each year. Thus at no time did any of the policies have a cash surrender value. The purported annual borrowing took the form of "loans" to prepay the annual insurance premiums in accordance with the Loan Agreement and a "loan" of the remaining cash value directly to Golsen. A schedule of the approximate total cash values and "loans" on the policies over the policies' first 20 years is set out below:

(1)	(2)	(3)	(4)	(5)
Year	Cash Value	Increase in Cash Value from Preceding Year	"Borrowing" Used to Pay Discounted Premium	Remaining Cash Value Available for Payment of "Interest"
1	$ 50,000.00	$50,000.00	$50,000.00	-0-
2	116,940.00	66,940.00	60,577.90	$ 6,362.10
3	185,440.00	68,500.00	60,577.90	7,922.10
4	255,500.00	70,060.00	60,577.90	9,482.10
5	327,130.00	71,630.00	60,577.90	11,052.10
6	400,350.00	73,220.00	60,577.90	12,642.10
7	475,140.00	74,790.00	60,577.90	14,212.10
8	551,500.00	76,360.00	60,577.90	15,782.10
9	629,420.00	77,920.00	60,577.90	17,342.10
10	708,880.00	79,460.00	60,577.90	18,882.10
11	789,860.00	80,980.00	60,577.90	20,402.10
12	872,330.00	82,470.00	60,577.90	21,892.10
13	956,250.00	83,920.00	60,577.90	23,342.10
14	1,041,590.00	85,340.00	60,577.90	24,762.10
15	1,128,270.00	86,680.00	60,577.90	26,102.10
16	1,216,250.00	87,980.00	60,577.90	27,402.10
17	1,305,430.00	89,180.00	62,391.50	26,788.50
18	1,395,730.00	90,300.00	64,266.40	26,033.60
19	1,487,060.00	91,330.00	67,196.00	24,134.00
20	1,579,280.00	92,220.00	68,180.00	24,040.00

Each year, Golsen purported to borrow from Western the amounts listed in columns (4) and (5), which represented the annual increase in the cash value of the policies (column (3)). At the same time, Golsen purported to pay to Western four percent interest on the aggregate "cash value" of the policies (all of which he had "borrowed") and four percent interest on the purported loan of $261,033.90 (the "prepaid premium fund").

The following table reflects the approximate amounts of Golsen's annual "interest" payments, Western's annual "loans" to Golsen, and Golsen's resulting out-of-pocket expenses (the difference between the first two amounts) as they were incurred and as they were anticipated under the "executive special" plan:

Year	"Interest" Payments	"Loans" to Golsen after "Borrowing" to Prepay Premium	Out-of-Pocket Expenses
1	$12,441.40	--	$23,019.40*
2	15,119.00	$ 6,362.10	8,756.90
3	17,859.00	7,922.10	9,936.90
4	20,661.40	9,482.10	11,179.30
5	23,526.60	11,052.10	12,474.50
6	26,455.40	12,642.10	13,813.30
7	29,447.00	14,212.10	15,234.90
8	32,501.40	15,782.10	16,719.30
9	35,618.20	17,342.10	18,276.10
10	38,796.60	18,882.10	19,914.50
11	42,035.80	20,402.10	21,633.70
12	45,334.60	21,892.10	23,442.50
13	48,691.40	23,342.10	25,349.30
14	52,105.00	24,762.10	27,342.90
15	55,572.20	26,102.10	29,470.10
16	59,091.40	27,402.10	31,689.30
17	60,162.90	26,788.50	33,374.40
18	61,204.20	26,033.60	35,170.60
19	62,209.60	24,134.00	38,075.60
20	63,171.20	24,040.00	39,131.20

* Includes $10,578.00 premium payment made in year (1).

Thus, prior to 1966 (year #5 in the above table) Golsen received a letter from Western which declared in part:

December 10, 1965

Jack E. Golsen
726 W. Sheridan Street
Oklahoma City, Oklahoma

Dear Mr. Golsen:

Enclosed is the premium due notices on your policies.

If you wish you may forward your check for the interest due and we will send our check to you so that you actually pay only the net amount due. This would give you a cancelled check for the total amount of interest paid for your income tax files.

Listed below is the amount of the checks which should be exchanged.

Your Check	Our Check	Net amount as shown on premium notice
#12560 thru 79—Jack E. Golsen		
$23,526.56	$11,052.96	$12,473.60 —

The amount of $23,526.56, denominated "Your Check," represented the purported interest payments on the $327,130 "cash value" "borrowed" and on the so-called prepaid premium fund. The amount of $11,052.96, denominated "Our Check" was the approximate[5] difference between the increase in the policies' cash surrender value ($71,630) and the portion of that amount which was purportedly used to prepay the insurance premium ($60,577.90). The amount of $12,473.60 is the difference between $23,526.56 and $11,052.96, and represented the net price which Golsen paid to Western.

[5] The discrepancy between the figure in the letter ($11,052.96) and the actual difference ($11,052.10) is unexplained.

Western did not record the "prepayments" on its books as the actual payment of premiums for future years; rather, it treated the "prepayments" as a deposit or "fund" in favor of Golsen, against which (as augmented by interest at three percent) it annually charged the future premiums in the amount of $68,180 a year. For the purpose of reporting its income for financial and tax accounting each year Western reported the amount of $68,180 as premium income attributable to the policies here involved; reported the alleged interest in the amount of four percent of the cash value borrowed and four percent of the prepaid premium fund as interest income; and reported the difference between the "annual premium" as reflected in the policy and the discounted premium of $60,577.90 as interest expense.

Since the "executive special" plan contemplated systematic borrowing of each policy's entire cash value, the policies effectively had no cash value and accordingly were comparable to renewable term insurance policies. The so-called annual premium on the "executive special" policies was set at an artificially high level so as to create an abnormally high cash value in order to facilitate or make possible the purported lending transaction, and Golsen's annual out-of-pocket expense or net cash flow (i.e., the payments denominated as interest, as reduced by the cash that was returned by the insurance company) is merely the amount that was actuarially required to pay for or support the insurance benefits available under the policies when stripped of their cash surrender values. Such "interest" payments in fact represent the cost to the insured of the insurance benefits provided by the "executive special" policies under the prearranged plan and do not represent payment for the use of borrowed funds.

Golsen's "loans" were secured solely by the policies themselves and the so-called premium prepayment fund, without any personal liability on his part; the "loans" could be cancelled at any time without any cash payment, merely

y appropriate offsetting book entries, and the full amount of the so-called premium prepayment fund was in fact thus "charged off" on Western's books on January 26, 1967, accompanied by a corresponding entry reducing Golsen's "indebtedness" by the amount allocable to such "fund."

On their joint Federal income tax return for the calendar year 1962, the Golsens claimed a deduction for "interest" paid to Western in the amount of $12,441.40. In his notice of deficiency the Commissioner disallowed the deduction.

OPINION

RAUM, *Judge:* This case involves an ingenious device which, if successful, would result in petitioner's purchase of a substantial amount of life insurance for the protection of his family at little or no after-tax cost to himself, or possibly even with a net profit in some years. The device is based on an unusual type of insurance policy that appears to have been specially designed for this purpose in which the rates were set at an artificially high level with correspondingly high cash surrender and loan values to begin immediately during the very first year of the life of the policy. The plan contemplated the purchase of a large amount of such insurance, the "payment" of the first year's premium, the simultaneous "prepayment" of the next four years' premiums discounted at the annual rate of three percent, the immediate "borrowing" of the first year's cash value at four percent "interest," and the immediate "borrowing" back of the full reserve value generated by the "prepayment," also at four percent "interest." Each year thereafter, the plan called for the "borrowing" of the annual increase in the loan or cash value of the policy at four percent "interest"; such increase, as a result of the artificially high premium, was more than sufficient to "prepay" the discounted amount of the premium which would become due four years thereafter. The net result of these complicated maneuvers would be that the insured's net out-

of-pocket (pre-tax) expenditures each year would be equal to the true actuarial cost of the insurance benefits that he was purchasing, (i.e., net death benefits in substantial amounts even after the policies had been stripped of their cash surrender values)—although, in form, he appeared to be paying large amounts of "interest." At the heart of the device is the deduction allowed in section 163(a) of the 1954 Code with respect to "interest paid * * * on indebtedness." And if the device were successful, the deduction would reduce the after-tax cost of the insurance either to a small amount, or nothing at all, or there might even be a net profit, depending upon the tax bracket of the owner of the policy. Apart from a portion of the amount paid the first year as "premiums" or "advance premiums," the remaining cash actually paid that year, and all other actual cash payments made by the insured throughout the life of the policy would be characterized as "interest."

The Government contends that the "loan" features of such insurance contracts are devoid of economic substance, that taking these features as part of an integrated plan, no true "indebtedness" was created nor was any bona fide "interest" paid (regardless of whether any such feature might otherwise qualify under the statute if considered individually in isolation from the companion features),[6] that the substance of the transaction was that the "interest" merely reflected the annual price which the insured

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[6] Compare *Gordon MacRae*, 34 T.C. 20, 27, affirmed and remanded 294 F. 2d 56 (C.A. 9), certiorari denied 368 U.S. 955:

> The steps taken, each in itself a legitimate commercial operation, were here each mirror images, and add up to zero. The various purchases and sales, each real *without the other*, neutralize one another and fairly shout to the world the essential nullity of what was done. No purchase and no sale is essentially identical with what was done here, i.e., identical and virtually simultaneous purchases and sales. The choice of the more complicated and involved method of doing nothing had no purpose, save the erection of the facade upon which petitioners now seek to rely.

paid for life insurance protection, and that such payment is nothing more than a nondeductible personal expense.

The nature of the problem is one that the Court is obviously ill-equipped to handle without expert actuarial assistance, and it was fortunate in this case to have the benefit of the testimony of an actuary who appeared to us to be highly qualified, and who presented a clear and convincing analysis of the transaction before us. That testimony established to our satisfaction that the receipt and prepayment agreement and the loan agreement and assignment of policy had no essential relationship whatever to the insurance benefits provided under the insurance contracts, that when, in accordance with the prearranged plan, the policy was stripped of its artificially high cash surrender values, such policy was merely the equivalent of renewable term insurance, and that actuarially the net cash which the insured in fact paid to the insurance company, however described, merely represented the true cost of the insurance purchased. In the latter connection, the actuary testified as follows:

> The payments that are denominated as interest, when reduced by the cash that was returned from the insurance company, are the amounts that are left to support the insurance. In other words, they are the cost to the insured for which, in return, he gets the death benefit protection promised by the insurance company.

We are satisfied as to the soundness of this testimony and accept it as true. The purported loans herein were utterly devoid of economic substance and were simply the means whereby the true cost of the insurance—i.e., the true premiums in respect of the insurance really purchased—was reflected in the purported "interest" allegedly "paid" on such "loans." The "interest" was thus not in fact compensation paid for the use of borrowed funds, the essential

prerequisite for the deduction. See *Old Colony Railroad Co.* v. *Commissioner*, 284 U.S. 552, 560; *Deputy* v. *DuPont*, 308 U.S. 488, 497-498. As a consequence, if substance rather than form were to govern the result herein, we would conclude that the "interest" deduction here claimed is not allowable.[7]

It has repeatedly been held that the substance of a transaction rather than the form in which it is cast is determinative of tax consequences unless it appears from an examination of the statute and its purpose that form was intended to govern. The following represent merely a random selection from a wide variety of such cases that are too numerous for comprehensive listing: *Commissioner* v. *P.G. Lake, Inc.*, 356 U.S. 260, 265-267; *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334; *Griffiths* v. *Helvering*, 308 U.S. 355; *Higgins* v. *Smith*, 308 U.S. 473; *Minnesota Tea Co.* v. *Helvering*, 302 U.S. 609; *Gregory* v. *Helvering*, 293 U.S. 465; *Weller* v. *Commissioner*, 270 F. 2d 294 (C.A. 3), affirming 31 T.C. 33 and *W. Stuart Emmons*, 31 T.C. 26;

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[7] Moreover, even apart from the essential character of the transaction as reflecting the payment of premiums rather than interest, the payments under consideration do not in fact appear to represent compensation for the use of borrowed funds. Thus in 1962 Golsen purported simultaneously to pay five premiums on each of his policies and then "borrow" back nearly the entire amount which he had just paid out. At the same time, he also purported to pay "interest" on the funds which he had just "borrowed." The net result of the transaction was that Golsen paid "interest" (at the rate of four percent) to Western in order to obtain the use of funds which were originally his and which he had transferred to Western (where they would "earn" three percent) for the very purpose of borrowing back—a transaction that was utterly lacking in economic substance. It is, of course, not unheard of for the owner of a policy to borrow the current cash value; one of the advantages of such a policy is that it provides a ready source of funds in the event of a need for cash for any purpose. But it is plain that from the outset Golsen intended to "borrow back" funds immediately after "paying" them over to Western. Unlike a lender, Western did not give up the use of funds from which it would have otherwise derived benefit. Unlike a borrower, Golsen did not obtain the use of funds which he would not otherwise have enjoyed.

William R. Lovett, 37 T.C. 317. The thought was forcefully expressed in the now familiar language of *Minnesota Tea Co.* v. *Helvering, supra;* 302 U.S. at 613, as follows: "A given result at the end of a straight path is not made a different result because reached by following a devious path." In terms of the present case, "the given result at the end of [the] straight path" was the payment of the cost for insurance protection, and "the different result by following a devious path" was reflected in the attempt to make such payments appear to be interest through the involved "loan" transactions.

Insurance and annuity policies are peculiarly susceptible of manipulation so as to create illusion, and, in applying the substance-versus-form doctrine in such instances courts have at times referred to the transactions under review as "shams," or have characterized them as lacking in "business purpose," cf. *Knetsch* v. *United States*, 364 U.S. 361. Petitioners have seized upon such language, urging upon us that Golsen's transaction was not a "sham," that he was seriously buying life insurance for the protection of his family, and that there was thus no absence of "business purpose." The difficulty with that position is that, granted that there was a legitimate reason for the underlying acquisition of life insurance, there does not appear to be any such reason for the otherwise wholly meaningless superstructure of "loans" erected on that base. The point was articulated with telling clarity in Ballagh v. United States, 331 F. 2d 874 (Ct. Cl.), certiorari denied 379 U.S. 887, where the Court of Claims stated (p. 878):

> [P]laintiff is wide of the mark in supposing that his primary purpose of providing retirement income can make valid what would otherwise be a sham. For the transaction which we find to be a sham is not the initial insurance contract but the prepayment of all of the premiums and the loan agreement. We do not question that plaintiff's motive in buying the policy was a

legitimate one. However, the subsequent prepayment of all premiums by borrowing from the insurance company itself was not necessary in so providing retirement income, and we find that such loan transaction did "not appreciably affect his beneficial interest except to reduce his tax."

See also *Minchin* v. *Commissioner*, 335 F: 2d 30, 32 (C.A. 2).

Petitioners claim to find support for their position in this case by reason of the fact that Golsen's policies were issued in 1961 or early 1962. They rely upon section 264(a)(3) which was added to the 1954 Code in 1964[8] and which provides as follows:

> SEC. 264. CERTAIN AMOUNTS PAID IN CONNECTION WITH INSURANCE CONTRACTS.
>
> (a) General Rule.—No deduction shall be allowed for—
>
> * * * * * * *
>
> (3) Except as provided in subsection (c), any amount paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance, endowment, or annuity contract (other than a single premium contract or a contract treated as a single premium contract) pursuant to a plan of purchase which contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of such contract (either from the insurer or otherwise).
>
> * * * Paragraph (3) shall apply only in respect of contracts purchased after August 6, 1963.

The point is defective. Of course, section 264(a)(3) does not prohibit the deduction in respect of policies purchased

[8] See Section 215, Revenue Act of 1964.

before August 6, 1963, and there was no specific prohibition prior thereto in the Internal Revenue Code against such deduction.[9] But petitioners' right to the claimed deduction is based upon section 163, not section 264. The latter simply denies, or disallows, or prohibits deductions that might otherwise be allowable under some other provision of the statute. It does not confer the right to any deduction,[10] and the August 6, 1963 date represents merely the starting point for the operative effect of the specific disallowance provisions of section 264(a)(3). A closely parallel situation was considered in *Knetsch* v. *United States, supra,* 364 U.S. at p. 367, where the Supreme Court held that a similar provision relating to deductions denied under section 264(a)(2) did not confer a right to deduction in respect of contracts purchased prior to the stated operative date of those provisions.[11] If the deduction sought by petitioners did not come within the provisions of section 163 prior to the 1964 amendment to the Code, nothing in that amendment retroactively created any such right. Cf. *W. Lee McLane, Jr.*, 46 T.C. 140, affirmed 377 F. 2d 557 (C.A. 9), certiorari denied 389 U.S. 1038.

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[9] See H. Rept. 749, 88th Cong., 1st Sess., pp. 61, 62; S. Rept. 830, 88th Cong., 1st Sess., pp. 77-79.

[10] See *Weller* v. *Commissioner,* 270 F. 2d 294, 298 (C.A. 3), where the Court of Appeals said:

> Section 24(a) [predecessor section 264] applies to specific items that are *not* deductible. The section does not even purport to indicate what items are deductible and, therefore, legislative history indicating that annuity contracts were specifically not included therein fails to conclude the issue. Regardless of Section 24(a)(6), the taxpayers' payments must still qualify as interest under Section 23(b) [predecessor section 163] to be deductible.

See also dissent of Wisdom, J., in *United States* v. *Bond,* 258 F. 2d 577, 584 (C.A. 5), which was cited with apparent approval by the Supreme Court in *Knetsch* v. *United States, supra,* 364 U.S. at 366, fn. 4.

[11] The committee reports with respect to those provisions, which the Supreme Court found not to be controlling in *Knetsch,* 364 U.S. at p. 369, fn. 7, bear a close resemblance to the committee reports relied upon by petitioners herein, fn. 9, *supra.*

The precise question relating to the deductibility of "interest" like that involved herein has been adjudicated by two courts of appeals. In one case, *Campbell* v. *Cen-Tex, Inc.*, 377 F. 2d 688 (C.A. 5), decision went for the taxpayer;[12] in the other, *Goldman* v. *United States*, 403 F. 2d 776 (C.A. 10), affirming 273 F. Supp. 137 (W.D. Okla.), the Government prevailed. *Goldman* involved the same insurance company, the same type of policies, and the same financial arrangements as are before us in the present case. *Cen-Tex* involved a different insurance company but dealt with comparable financing arrangements. Despite some rather feeble attempts on the part of each side herein to distinguish the case adverse to it, we think that both cases are in point. It is our view that the Government's position is correct.

Moreover, we think that we are in any event bound by *Goldman* since it was decided by the court of appeals for the same circuit within which the present case arises. In thus concluding that we must follow *Goldman*, we recognize the contrary thrust of the oft-criticized[13] case of *Ar-*

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[12]The same result was reached in two district cases. *Priester Machinery Co.* v. *United States*, 296 F. Supp. 604 (D.C. Tenn.); *Wanvig* v *United States*, 295 F. Supp. 882 (D.C. Wisc.), affirmed on another issue, ... F. 2d ..... (C.A. 7, March 11, 1970).

[13]*Norvel Jeff McLellan*, 51 T.C. 462, 465-467 (concurring opinion); *Automobile Club of New York*, 32 T.C. 906, 923-926 (dissenting opinion), affirmed, 304 F. 2d 781 (C.A. 2); *Robert M. Dann*, 30 T.C. 499, 510 (dissenting opinion); Del Cotto, The Need for a Court of Tax Appeals: An Argument and a Study, 12 Buffalo L. Rev. 5, 8-10 (1962); Vom Baur & Coburn, Tax Court Wrong in Denying Taxpayer the Rule Laid Down in His Circuit, 8 J. of Taxation 228 (1958); Orkin, The Finality of the Court of Appeals Decisions in the Tax Court: A Dichotomy of Opinion, 43 A.B.A.J. 945 (1957); Note, Heresy in the Hierarchy: Tax Court Rejection of Court of Appeals Precedents, 57 Colum. L. Rev. 717 (1957); Note, Controversy Between the Tax Court and Courts of Appeals: Is the Tax Court Bound by the Precedent of Its Reviewing Court?, 7 Duke L.J. 45 (1957); Note, The Tax Court, the Courts of Appeals, and Pyramiding Judicial Review, 9 Stan. L. Rev. 827 (1957); Case note, 70 Harv. L. Rev. 1313

thur L. Lawrence, 27 T.C. 713. Notwithstanding a number of the considerations which originally led us to that decision, it is our best judgment that better judicial administration[14] requires us to follow a court-of-appeals decision which is squarely in point where appeal from our decision lies to that court of appeals and to that court alone.[15]

Section 7482(a), I.R.C. 1954,[16] charges the courts of appeals with the primary responsibility for review of our decisions, and we think that where the court of appeals to which appeal lies has already passed upon the issue before us, efficient and harmonious judicial administration calls for us to follow the decision of that court. Moreover, the practice we are adopting does not jeopardize the Federal

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[13] (Continued)

(1957). See also *Sullivan* v. *Commissioner*, 241 F. 2d 46 (C.A. 7), affirmed, 356 U.S. 27; *Stern* v. *Commissioner*, 242 F. 2d 322 (C.A. 6), affirmed, 357 U.S. 39; *Stacey Mfg. Co.* v. *Commissioner*, 237 F. 2d 605 (C.A. 6).

[14] The importance of the *Lawrence* doctrine in respect of the functioning of this Court has been grossly exaggerated by some of the critics of that decision. That case was decided January 25, 1957, and this is the first time during the intervening period of somewhat in excess of 13 years that the Court has ever deemed it appropriate to face the question whether or not to apply the *Lawrence* doctrine.

[15] Section 7482(b)(2), I.R.C. 1954, grants venue in any court of appeals designated by both the Government and the taxpayer by written stipulation. However, if the court of appeals to which an appeal would otherwise lie has already passed upon the question in issue, it is hardly likely that the party prevailing before the Tax Court would join in such a stipulation.

[16] SEC. 7482. COURTS OF REVIEW.

(a) Jurisdiction.—The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

interest in uniform application of the internal revenue laws which we emphasized in *Lawrence*. We shall remain able to foster uniformity by giving effect to our own views in cases appealable to courts whose views have not yet been been expressed, and, even where the relevant court of appeals has already made its views known, by explaining why we agree or disagree with the precedent that we feel constrained to follow. See Note, 57 Colum. L. Rev. supra at 723.

To the extent that *Lawrence* is inconsistent with the views expressed herein it is hereby overruled. We note, however, that some of our decisions, because they involve two or more taxpayers, may be appealable to more than one circuit. This case presents no such problem, and accordingly we need not decide now what course to take in the event that we are faced with it.

In view of the conclusion reached above we find it unnecessary to consider the Government's alternative contention that the claimed deduction is in any event forbidden by section 264(a)(2).

Reviewed by the Court.

Decision will be entered for the respondent.

WITHEY, *J.*, dissenting: While I agree with the conclusion of the Court on the merits of this case, I dissent on the reversal of this Court's position on *Arthur L. Lawrence*, 27 T.C. 713, by the majority.

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In the Supreme Court of the United States

OCTOBER TERM, 1971

JACK E. GOLSEN and SYLVIA H. GOLSEN,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the Tax Court (Pet. App. xi-xxxv) is reported at 54 T.C. 742. The opinion of the court of appeals (Pet. App. i-x) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on June 18, 1971. The petition for a writ of certiorari was filed on September 13, 1971. The jurisdic-

tion of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTION PRESENTED

Whether purported loans from an insurance company to petitioner Jack E. Golsen, lacked economic substance—serving no purpose other than to convert premium payments for insurance into interest payments for tax purposes—with the result that the amounts in issue were not deductible "interest on indebtedness" within the meaning of Section 163(a) of the Internal Revenue Code.

STATUTE INVOLVED

Internal Revenue Code of 1954 (26 U.S.C.):

> SEC. 163. INTEREST.
>
> (a) *General Rule.*—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

* * * *

STATEMENT

On January 31, 1962, the Western Security Life Insurance Company (Western) issued to petitioner [1] 20 "executive special" life insurance policies, each having a face amount of $50,000. These policies named petitioner as the insured, his wife as the primary beneficiary, and the couple's three children as

[1] References to petitioner are to Jack E. Golsen. Sylvia H. Golsen is a party only because a joint income tax return was filed.

contingent beneficiaries. On their face, the policies appeared to be whole life policies which provided for an aggregate premium of $68,180 per year for the first 20 years and $18,180 per year thereafter. (Pet. App. ii, xxv.)

The insurance program operated as follows:

1. In the first year, petitioner "paid" to Western the first year premium ($68,180) and the present value of the next four years' annual premiums, discounted at three percent ($253,431.90), for a total of $321,611.90. The prepayment when supplemented by the interest to be earned thereon was designed to be sufficient to pay the next four annual premiums as they became due. Petitioner also "paid" Western $12,441.40 as "interest" on the total amount "borrowed" from Western under terms described immediately below. (Pet. App. iii, xv, xix.)

2. Also during the first year, petitioner "borrowed" $311,033.90 from Western at annual "interest" of four percent. The "loan" consisted of the entire first year cash surrender value of the policies ($50,000), which petitioner used to pay the greater part of the first year's premium, and an additional larger sum ($261,033.90), which he used to establish the prepaid premium fund. (Pet. App. iii, xv, xix-xx.)

3. In each succeeding year, petitioner would replenish the prepaid premium fund by "prepaying" the premium (discounted at three percent) due four years later ($60,577.90). To do so, he would increase his "loan" by "borrowing" the entire increase in

cash surrender value (which was always greater than the $60,577.90 added to the prepaid premium fund), and would use the "borrowed" amount to pay the addition to the prepaid premium fund in full and a portion of the annual four percent "interest" charge on his increasing "indebtedness" to Western. As a result of this planned "borrowing" the policies at no time had a cash surrender value. (Pet. App. iii-iv, xv-xvi, xxii-xxiii.)

Thus, after the first year, petitioner would incur no out-of-pocket cost for insurance coverage, and the entire amount of his actual cash payment would be characterized as "interest." At issue here is the deductibility of these payments. If deductible, then depending on petitioner's tax bracket, the actual cost of the insurance death benefit protection provided under the insurance contract would either be nominal in amount, or, under ideal circumstances (where petitioner was in a sufficiently high tax bracket), would be zero, with petitioner actually making a net profit on the transaction because the tax benefit of the interest deduction exceeded his out-of-pocket cost. The attractiveness of the arrangement to petitioner was enhanced because he was never personally liable on any of his "borrowing," and because the "loans" could be cancelled at any time without further cash payment, as was, in fact, done on January 26, 1967, by offsetting book entries on Western's books. (Pet. App. iv-v, xvi-xvii, xxv-xxvii.)

Based on the expert testimony of an actuary, the Tax Court held that the annual premium was set at an artifically high level to create an abnormally high

cash surrender value; that petitioner's out-of-pocket costs constituted, in substance, premiums for term insurance in an amount equal to the excess of the face amount of the policies over the stated cash surrender value thereof; and that the amounts in issue therefore were not deductible "interest on indebtedness" within the meaning of Section 163(a) of the Internal Revenue Code, p. 2, *supra*. (Pet. App. v-vi.) The court of appeals affirmed (Pet. App. xiii-xiv).

ARGUMENT

The decision below is correct. Although there is a conflict of decisions, the issue presented has been rendered moot with respect to contracts entered into after August 6, 1963, by amendments to Section 264 of the Internal Revenue Code enacted by the Revenue Act of 1964.

1. Expert testimony at trial established that petitioner's out-of-pocket costs were actuarially no more than the amount required to support or pay for the insurance death benefits actually available under the policies, considering the fact that the policies at all times lacked cash surrender value. It follows, therefore, that the payments designated as "interest" were, in substance, nothing more than premiums for term insurance coverage, and were not payments for the use of borrowed money. See *Deputy* v. *du Pont*, 308 U.S. 488, 497-498; *Old Colony Railroad Co.* v. *Commissioner*, 284 U.S. 552, 560. The decision below that the insurance program lacked economic substance is supported not only by expert ac-

tuarial testimony, but also by the fact that petitioner paid "interest" at four percent to obtain the use of funds which were originally his and which he had "loaned" to the insurance company at three percent. Under similar circumstances, this Court has held that interest deductions are not available. See *Knetsch* v. *United States*, 364 U.S. 361.

2. The decision here is in conflict with that of the Fifth Circuit in *Campbell* v. *Cen-Tex, Inc.*, 377 F. 2d 688. But, despite the conflict, the issue is not of sufficient importance to warrant review by this Court. Legislation applicable to insurance contracts purchased after August 6, 1963—the contracts here and in *Cen-Tex, Inc.* were purchased before the cut-off date—specifically bars an interest deduction where, as here, an amount is paid "pursuant to a plan of purchase which contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of such contract (either from the insurer or otherwise)." Section 264(a)(3) of the Code, as added by Sec. 215(a)(1) Revenue Act of 1964, P.L. 88-272, 78 Stat. 55. The Internal Revenue Service advises that, in addition to the instant case, there are presently pending, judicially and administratively, similar cases involving only eight taxpayers and approximately $400,000 of tax, which are not subject to the 1964 legislation.[2]

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[2] One of these is *Woodson-Tenant Laboratories, Inc.* v. *United States*, 71-1 U.S.T.C., par. 9216 (W.D. Tenn.), pending on the government's appeal in the Sixth Circuit (No. 71-1371), in which the district court followed the Fifth Circuit's decision in *Cen-Tex, Inc.*

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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